

Message Text

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PAGE 01 STATE 229942

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TO AMEMBASSY TEHRAN PRIORITY

C O N F I D E N T I A L STATE 229942

EXDIS

E.O. 11652: GDS

TAGS: ENRG, IR

SUBJECT: BILATERAL OIL AGREEMENT

FOR AMBASSADOR ONLY

1. REQUEST AMBASSADOR CONVEY FOLLOWING MESSAGE FROM FRAN ZARB TO ANSARY, NOTING THAT IT CONTAINS NEW FORMULA FOR NEGOTIATION IF GOI IS INTERESTED.

2. TEXT: AT OUR LONDON MEETING IN EARLY AUGUST, I INDICATED THAT WE WOULD REVERT TO YOU WITH THREE ITEMS:

FIRSTLY, AN ASSESSMENT OF YOUR COUNTER PROPOSAL TO MY PROPOSAL CONCEPT OF JUNE SUGGESTING A SIGNIFICANT DOWN PAYMENT IN EXCHANGE FOR A FIXED PRICE THROUGHOUT THE CONTRACT PERIOD.

SECONDLY, INFORMATION ON US DEFENSE DEPARTMENT OIL PURCHASE PRICES.

CONFIDENTIAL

CONFIDENTIAL

PAGE 02 STATE 229942

THIRDLY, AN ALTERNATIVE PROPOSAL CONCEPT, THE CENTRAL FEATURE OF WHICH WOULD BE A DEFERRED PAYMENT SCHEME.

COUNTER PROPOSAL

OUR ASSESSMENT OF YOUR COUNTER PROPOSAL SUPPORTS OUR INITIAL REACTION IN LONDON. INTRODUCING PRICE ESCALATION AND INCREASING THE SIZE OF THE DOWN PAYMENT WOULD ELIMINATE THE FINANCIAL INCENTIVE THAT WOULD WARRANT OUR PURSUING THIS UNUSUAL PROCUREMENT PLAN.

DEFENSE DEPARTMENT OIL PRICES

YOU UNDERSTAND, I BELIEVE, THAT THE DEFENSE DEPARTMENT BUYS ONLY REFINED PRODUCTS. PURCHASES FROM US DOMESTIC SOURCES ARE, OF COURSE, AT THE PREVAILING LEVELS PERMITTED UNDER OUR REGULATORY POLICIES. CONTRACTS FOR PURCHASES FROM SOURCES OUTSIDE THE UNITED STATES GENERALLY PROVIDE SIGNIFICANT DISCOUNTS OFF PREVAILING MARKET PRICES, BUT IT IS DIFFICULT TO QUANTIFY THESE DISCOUNTS BECAUSE THE PRODUCTS OBTAINED REPRESENT AN IMPERFECTLY BALANCED BARREL, VARIOUS CRUDE OIL TYPES, FREIGHT RATES, REFINERY YIELDS AND MARGINS AND MARKET PRICES FOR OTHER PRODUCTS. THEREFORE, WHILE COMPARATIVE DATA ON OTHER INTERNATIONAL OIL PRODUCT TRANSACTIONS INDICATE THAT THE DEFENSE DEPARTMENT OBTAINS ITS PRODUCTS AT ATTRACTIVE DISCOUNTS, WE CANNOT WITH CONFIDENCE STATE THE SPECIFIC CRUDE OIL PRICES THAT WOULD BE DERIVED FROM DEPARTMENT PRODUCTS CONTRACTS.

DEFERRED PAYMENT CONCEPT

THE FOLLOWING PRELIMINARY OUTLINE OF AN ALTERNATIVE CONCEPT COULD, I BELIEVE, BE THE BASIS OF AN AGREEMENT FOR SUPPLY TO THE US STRATEGIC PETROLEUM RESERVE. IF YOU THINK IT MERITS FURTHER CONSIDERATION, I CAN DEVELOP IT IN GREATER DETAIL.

(A) A CONTRACT FOR APPROXIMATELY SIX YEARS AVERAGING UP TO 150-THOUSAND BARRELS DAILY, DELIVERIES COMMENCING
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CONFIDENTIAL

PAGE 03 STATE 229942

IN THE SUMMER OF 1977.

(B) SINCE THE RESERVE HAS A LIMITED NEED FOR HEAVY CRUDES, THE CONTRACT WOULD BE FOR LIGHT CRUDES WITH THE PROVISION THAT THE SUPPLIER COULD SUBSTITUTE UP TO FORTY PERCENT HEAVY CRUDE SUBJECT TO THE PRICING PROVISIONS BELOW AND WITH THE AGREEMENT THAT THE BUYER WOULD NORMALLY EXCHANGE SUCH HEAVY CRUDES FOR OTHER

LIGHTER CRUDES MORE SUITABLE FOR THE RESERVE.

(C) BASE SELLING PRICES EQUAL TO NET SELLING PRICES TO CONSORTIUM DURING THE LAST QUARTER 1976; PROVIDED HOWEVER, THAT FURTHER DISCOUNTS WILL BE AFFORDED SUFFICIENT TO ASSURE THAT ACTUAL EXCHANGES BY FEA OF HEAVY CRUDE FOR CRUDES REQUIRED BY THE RESERVE ARE TRANSACTED AT NO FINANCIAL LOSS TO FEA.

(D) NORMAL CREDIT TERMS PLUS AN ADDITIONAL 60 DAYS WOULD APPLY TO CURRENT PAYMENTS.

(E) PAYMENT FOR THE ACCUMULATED AMOUNT OF ANY PRICE INCREASES OVER THE INITIAL BASE SELLING PRICE OCCURRING DURING THE TERM OF THE CONTRACT TO BE DEFERRED UNTIL ANY OF THE OIL IS RELEASED FROM THE RESERVE TO THE COMMERCIAL MARKET OR JUNE 30, 1985, WHICHEVER IS EARLIER THE DEFERRED PAYMENT COVERING PRICE INCREASES WOULD BEAR NO INTEREST.

(F) OTHER TERMS AND CONDITIONS TO BE INCLUDED IN AN AGREEMENT WOULD BE SUBJECT TO NEGOTIATION.

AS YOU KNOW, OUR INTEREST IS DEPENDENT UPON THERE BEING A SIGNIFICANT FINANCIAL BENEFIT THAT WARRANTS OUR JUSTIFYING TO CONGRESS A DEPARTURE FROM NORMAL GOVERNMENT PROCUREMENT PRACTICES.

IF THIS CONCEPT IS NOT OF INTEREST TO YOU, OUR NORMAL BIDDING PROCEDURES FOR PERIODIC SUPPLY CONTRACTS WOULD, OF COURSE, PROVIDE YOU AND OTHERS WITH OPPORTUNITIES TO PARTICIPATE IN OUR STRATEGIC RESERVE PROGRAM.

CONFIDENTIAL

CONFIDENTIAL

PAGE 04 STATE 229942

WE ARE IN THE PROCESS OF DEVELOPING OUR FINAL RECOMMENDATIONS ON PROCUREMENT PROCEDURES FOR REVIEW BY THE EXECUTIVE BRANCH AND CONSULTATION WITH CONGRESS. CONSEQUENTLY, I WOULD APPRECIATE YOUR REACTION TO MY PROPOSAL CONCEPT BY EARLY OCTOBER.

IF THE ABOVE CONCEPT IS GENERALLY OF INTEREST TO YOU, WE ARE PREPARED TO MEET WITH YOU FOR FURTHER DISCUSSIONS IT IS ALWAYS A PLEASURE TO SHARE YOUR GOOD COMPANY. END TEXT. HABIB

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